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JUL 31 1992

FEDERAL COMMUNICATIONS COMMISSION  
OFFICE OF THE SECRETARY

July 31, 1992

Ms. Donna R. Searcy  
Secretary  
Federal Communications Commission  
1919 M Street, N.W.  
Room 222  
Washington, D.C. 20554

RE: In the Matter of Treatment of Local Exchange Carrier Tariffs Implementing Statement of Financial Accounting Standards, "Employers Accounting for Postretirement Benefits Other than Pensions", CC Docket No. 92-101

Dear Ms. Searcy,

Attached are the original and five copies of the Reply to Oppositions to Direct Case of the United Telephone Companies in the proceeding referenced above.

Sincerely,

Richard D. Lawson  
Director  
Federal Regulatory Relations

Attachments

RDL/mlm

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Before the  
FEDERAL COMMUNICATIONS COMMISSION  
Washington, D.C.

JUL 31 1992

FEDERAL COMMUNICATIONS COMMISSION  
OFFICE OF THE SECRETARY

In the Matter of )  
 )  
Treatment of Local Exchange )  
Carrier Tariffs Implementing )  
Statement of Financial ) CC Docket No. 92-101  
Accounting Standards, )  
"Employers' Accounting for Post- )  
retirement Benefits Other )  
Than Pensions" )

United Telephone System  
Companies Reply to  
Oppositions to Direct Case

The United Telephone System companies ("United") hereby reply to the Oppositions<sup>1</sup> to United's June 1, 1992 Direct Case filed in this proceeding. In its Direct Case United asked the Commission to grant an exogenous change to price cap index ("PCI") levels to recover the incremental costs arising from implementation of SFAS-106.

I. United Will Be Disadvantaged

In its Direct Case, United pointed out that it would be disproportionately disadvantaged, in comparison to many other price cap carriers, unless exogenous treatment is granted for the incremental costs of SFAS-106. As United noted, many other carriers have already been permitted by the Commission to accrue

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1. Oppositions were filed by AT&T, Ad Hoc Telecommunications Users Committee ("Ad Hoc"), MCI Telecommunications Corporation ("MCI") and the International Communications Association ("ICA").

and include OPEB expenses in rate development prior to the issuance of SFAS-106.<sup>2</sup>

Ad Hoc disputes United's claim that it will be disproportionately disadvantaged.<sup>3</sup> Ad Hoc claims that first, there will be no discrimination because the costs associated with SFAS-106 were accounted for in the unitary rate of return established by the Commission.<sup>4</sup> Secondly, Ad Hoc claims that even if United is disadvantaged, it is only as to other LECs with which United does not compete, not as to most U.S. firms in the larger markets for capital.

As to the former Ad Hoc is mistaken; the LECs have not been made whole for the costs of SFAS-106 through rate of return represcription. Ad Hoc's argument is thoroughly rebutted by USTA in its Rebuttal to Oppositions being filed on even date herewith and United will not burden the Commission by repeating those arguments here.

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2. Indeed, as AT&T points out in its Opposition at page 15, footnote \*: "Most LECs included some level of SFAS 106 accrual accounting costs beyond "pay-as-you-go" amounts prior to price caps, and these amounts are already reflected in their PCIs...."

3. Ad Hoc Opposition, Appendix I, page 4, footnote 4.

4. MCI's Opposition at p. 11 also claims that the costs associated with OPEBs and SFAS-106 have already been accounted for in the context of the represcription of the interstate rate of return. (In the Matter of Represcribing the Authorized Rate of Return for Interstate Services of Local Exchange Carriers, CC Docket 89-624, Order, 5 FCC Rcd 25; and Memorandum Opinion and Order, released December 6, 1991.) However, MCI and Ad Hoc are both mistaken.

As to the latter, Ad Hoc misconstrues United's claim that it will be disadvantaged if exogenous treatment is not granted. United, unlike most of the other price cap carriers, elected to wait until mandatory implementation of SFAS-106, January 1993, to adopt accounting for OPEBs. Only pay-as-you-go costs were utilized by United in rate development prior to price caps and in United's initial price cap rates. Thus, unlike the other price cap carriers that have included and recovered some level of SFAS 106 costs, United will be foreclosed from ever recovering those costs if exogenous treatment is not granted. Clearly that was not the intent of the Commission when it stated: "... carriers that elected to wait until the GAAP change become effective before expending funds for OPEBs are not necessarily foreclosed from recovering these costs."<sup>5</sup>

## II. Godwins Study

United relied, as did most of the LECs that filed Direct Cases, on the Godwins study to demonstrate that the proposed exogenous cost changes will not be included in GNP-PI.<sup>6</sup> Each of the four opposing parties to the Direct Cases questioned the validity of the findings of the Godwins study. They directed a

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5. Policy and Rules Concerning Rates for Dominant Carriers, CC Docket 87-313, Order on Reconsideration 6 FCC Rcd 2662 at para. 62 (1991).

6. Peter J. Neuwirth and Andrew B. Abel, United States Telephone Association "Analysis of Impact of SFAS No. 106 Cost on GNP-PI", ("Godwins Study") February 1992. The Godwins Study was appended in full as Attachment B to Bell Atlantic's Direct Case.

broad range of criticism at the Godwins study, including objections that the study used an incorrect estimate of increased labor costs, used the wrong kind of a model, and used invented or made up numerical parameters.

At the request of USTA, Godwins has prepared a detailed response to this criticism. The response is attached to the USTA Rebuttal To Oppositions to Direct Case that is being filed with the Commission today. United hereby adopts and incorporates by reference the Godwins response. It demonstrates, among other things, that some of the Oppositions rely upon outdated information that has since been determined to be flawed, that at least one of the opposing parties simply did not understand the model Godwins used, and that at least one of the opposing parties ignored the specific language used in the study. The response refutes all of the objections and proves the validity of the results of the Godwins study as a reliable tool for determining the effect of exogenous treatment of the incremental costs of implementation of SFAS-106 on the GNP-PI.

### III. Limitations on Exogenous Treatment

AT&T and Ad Hoc suggest that exogenous treatment should only be allowed, if at all, to prefund OPEB costs. AT&T further suggests that use of a "tax-effective" VEBA Trust<sup>7</sup> is the appropriate method of prefunding OPEB costs. However, in United's situation, a VEBA or other prefunded mechanism would not

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7. Internal Revenue Code Section 501(c)(9), 26 U.S.C. § 501(c)(9).

be tax-effective and would actually be detrimental. United's investigation revealed that under present tax law it would incur tax liability on revenues collected for funding; however, only a small portion of the funded amount would be deductible for tax purposes. Consequently, with prefunding United would be in a position of having to borrow funds and incur costs to cover the portion of funding not deductible for tax purposes.

AT&T further suggests that mandatory prefunding should be ordered in order to ensure that amounts paid by ratepayers attributable to OPEBs are only used for OPEBs. No such mandatory prefunding is necessary to protect the ratepayers. The Commission has already provided ratepayer protection in RAO Letter 20.<sup>8</sup> There the Commission required rate base to be reduced by the amount of any unfunded accrued postretirement benefits. No further protection is necessary.

AT&T also argues for limits on the amount of accruals that receive exogenous treatment because the assumptions used in calculating OPEB costs are highly speculative and vary widely between the companies depending upon the assumptions used. AT&T points to, among other things, the variations in cost per employee amounts used by the different LECs. Ad Hoc also complains that the accruals are too liberal and the assumptions manipulated.

However, the mere fact that properly measuring OPEBs

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8. In re Uniform Accounting for Postretirement Benefits Other Than Pensions in Part 32, RAO Letter 20, released May 4, 1992.

requires predicting certain future events and trends does not make the assumptions inaccurate or the accruals speculative. OPEB assumptions and accruals are determined by consultation with skilled and certified actuaries who are professionals in the actuarial science. They have experience and training in measuring, analyzing, and assessing the values inherent in the OPEB accruals. Additionally, their work will be audited by external auditors for each LEC. Thus, the LECs' assessments of OPEBs have been prepared by external skilled professionals and are subject to review by independent auditors.

The OPEBs accruals require the assessment of three significant assumptions: demographic characteristics of employee and retiree populations; discount rate; and medical cost trend rate. As shown, each of these assumptions is far more definitive than AT&T suggests.

Actuaries have years of experience in tracking demographic data and developing assumptions. This same information is used to measure pension cost. The long history of data that supports these assumptions and years of actuarial experience with these assumptions greatly diminish the speculative nature of the measurement.

The definition of discount rates, "...rates of return on high-quality fixed-income investments currently available..."<sup>9</sup> indicates that this assumption is based upon known, current

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9. SFAS 106, par. 31.

facts; not speculative predictions. Rates of return on 30 year U.S. Treasury issues and long-term high grade corporate bonds are quoted routinely in publications and other financial sources. Accordingly, the appropriateness of the discount rate assumption can easily be analyzed and assessed.

Additionally, professional actuaries have years of experience in assessing medical costs for purposes of setting premiums in the health care insurance industry. Also, major insurers routinely report trends for medical and dental costs to match against the industry's predictions for these costs and to substantiate medical trend rate assumptions to be used in the immediate future. The LECs' assumptions extend farther into the future consequently creating a greater degree of uncertainty as to accuracy. However, the potential impact of this uncertainty is mitigated by utilizing assumed rates far below rates currently reported in the insurance industry.

Further, a wide variation in per employee OPEB cost between the LECs does not support that the measurement of the cost is flawed as the result of highly speculative assumptions. Rather, the inherent facts and data supporting the cost measurement, such as plan design, claims experience, and employee/retiree demographics, can and do support a wide variation in the per employee cost.

AT&T also suggests that exogenous treatment should be further limited such that no provisions for substantive plan increases in benefits be included. AT&T's argument ignores a



basic tenet of generally accepted accounting principles: recognition of the financial impacts of transactions should be based upon the "substance" of the transactions, rather than the "form." SFAS-106 embodies this concept by requiring companies to account for OPEBs based upon the substantive plan rather than the written plan, if differences exist. The objective is for the accounting to reflect the terms of the exchange between the employer (benefits provided) and the employee (services rendered), recognizing that the terms of the exchange and the provisions of written plans may be different.

AT&T also objects to the discount rate and health care trend rates used and suggests that a 9% discount rate and a 10% health care trend rate be mandated. AT&T further suggests that the health care trend rate should be reduced by 4% to eliminate the double count of OPEB-related costs recoverable through GNP-PI. AT&T's suggestions are without merit. Neither of its suggested rates are reflective of current or recent experience. Further, their double counting argument is flawed in several respects.

Recent rates of return on high-quality fixed-income investments currently available range from 7.5% to 8.3%. This range includes the rate of return on both 30 year Treasury issues and long-term high-grade corporate bonds during all of 1992. Thus a 9.0% discount rate would inappropriately undervalue the real OPEBs costs, when no apparent support exists for the 9.0% rate.

Additionally, medical cost trend rates recently quoted by fourteen major insurers (See Attached Appendix A prepared by The Wyatt Company, United's actuarial consulting firm.) range, for June 1992, from a low of 18.8% to a high of 24.0%. The mean for these quoted rates is 21.9%. Thus the rate suggested by AT&T would undervalue medical cost trends by approximately 50%. Again no apparent support exists for AT&T's rate.

AT&T suggests a 4% reduction in the health care trend rate as an alternative to the Godwins Study double count solution. AT&T claims a double counting will occur because the GNP-PI component of the PCI will increase as all firms with OPEB liabilities reflect increasing OPEB costs through higher prices. Also, AT&T claims the SFAS-106 accrual calculation includes the present value of future inflation. However, the Godwins response demonstrates that the Godwins Study accurately and correctly dealt with the double count issue and United will not double count SFAS-106 costs if exogenous treatment is granted.

In addition to the Godwins response, United also points out that AT&T's proposed 4% reduction solution is flawed. It assumes that all firms will raise prices because of SFAS-106. However, as the Godwins Study demonstrated only 32% of private sector employees work for firms that provide OPEBs subject to SFAS-106. Additionally, AT&T fails to recognize that the nominal discount rate used in determining the present value of SFAS-106 costs includes the impact of the expected general rate of inflation. Therefore, the present value calculation removes the impact of

inflation from the SFAS-106 costs.

IV. CONCLUSION

Having refuted the arguments of the opposing parties, United again urges the Commission to grant exogenous change to PCI levels to recover the incremental costs arising from implementation of SFAS-106.

Respectfully submitted,

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COMPANIES

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Their Attorneys

July 31, 1992

## APPENDIX A

**Insurer Trend Survey  
June 1992 Update**

COMPANY	MEDICAL							DENTAL						
	Dec-90	Mar-91	Jun-91	Sep-91	Dec-91	Mar-92	Jun-92	Dec-90	Mar-91	Jun-91	Sep-91	Dec-91	Mar-92	Jun-92
A	22.0%	22.0%	22.0%	22.0%	22.0%	22.0%	21.0%	11.0%	12.0%	12.0%	12.0%	12.0%	12.0%	12.0%
B	22.0%	22.0%	22.0%	22.0%	22.0%	22.0%	22.0%	12.0%	12.0%	12.0%	12.0%	12.0%	12.0%	12.0%
C	18.0%	19.5%	N/A	18.0%	18.0%	19.5%	N/A	10.0%	11.0%	N/A	10.0%	10.0%	10.3%	N/A
D	22.0%	21.0%	21.0%	22.0%	22.0%	22.0%	22.0%	12.0%	11.0%	11.0%	11.0%	11.0%	11.0%	11.0%
E	22.0%	22.0%	N/A	21.0%	21.0%	22.0%	22.0%	10.0%	10.0%	N/A	10.0%	10.0%	10.0%	10.0%
F	20.0%	20.0%	N/A	24.0%	24.0%	24.0%	24.0%	8.0%	11.0%	N/A	11.0%	11.0%	11.0%	11.0%
G	19.0%	22.0%	23.5%	19.0%	20.0%	20.0%	22.0%	10.0%	10.0%	10.0%	10.0%	10.0%	10.0%	10.0%
H	24.0%	24.0%	24.0%	22.0%	22.0%	22.0%	22.0%	11.0%	11.0%	11.0%	10.0%	10.0%	10.0%	11.0%
I	22.0%	23.0%	23.0%	23.0%	23.0%	22.0%	23.0%	11.0%	11.0%	11.0%	11.0%	11.0%	11.0%	11.0%
J	21.6%	N/A	23.5%	23.5%	23.5%	24.0%	23.3%	9.0%	N/A	10.0%	10.0%	10.0%	10.0%	10.0%
K	22.0%	22.0%	26.0%	25.0%	23.0%	23.0%	22.0%	11.0%	11.0%	11.0%	11.0%	11.0%	13.0%	11.0%
L	22.5%	22.5%	22.9%	22.0%	22.0%	21.5%	N/A	11.0%	11.0%	11.0%	11.0%	11.0%	12.2%	N/A
M	19.0%	19.0%	N/A	19.0%	19.0%	19.0%	N/A	10.2%	11.5%	N/A	11.5%	11.5%	10.8%	10.8%
N	22.0%	22.0%	N/A	N/A	N/A	N/A	N/A	11.0%	11.0%	N/A	N/A	N/A	N/A	N/A
O	18.9%	N/A	21.7%	22.0%	19.0%	17.2%	18.8%	10.8%	N/A	10.8%	10.8%	11.6%	11.6%	11.6%
P	19.9%	19.9%	19.9%	19.0%	20.0%	19.8%	19.8%	12.0%	12.0%	10.0%	12.0%	12.0%	12.0%	12.0%
Q	22.0%	22.0%	24.0%	22.0%	22.0%	22.0%	22.0%	11.0%	11.0%	13.0%	12.0%	12.0%	11.0%	11.0%
R	23.0%	22.0%	22.0%	23.0%	23.0%	22.0%	22.0%	11.5%	11.5%	11.5%	11.0%	11.0%	11.5%	11.5%
Mean	21.2%	21.6%	22.7%	21.7%	21.5%	21.4%	21.9%	10.7%	11.1%	11.1%	11.0%	11.0%	11.1%	11.1%

Note: Where an insurer quoted a range of factors, depending on region, deductible, etc., the factor shown above represents the mid-point of the range.

**CERTIFICATE OF SERVICE**

I, Melinda L. Mills, hereby certify that I have on this 31st day of July, 1992, sent via hand delivery a copy of the foregoing "United Telephone System Companies Reply to Oppositions to Direct Case" CC Docket No. 92-101 filed this date with the Secretary, Federal Communications Commission, to the persons listed below.

  
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